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SIPDIS

SENSITIVE

STATE FOR E, EUR/SE, AND EB/IFD  
TREASURY FOR OASIA - JLEICHTER AND MMILLS  
NSC FOR MBRYZA AND TMCKIBBEN

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [PREL](#) [PGOV](#) [TU](#)

SUBJECT: MEETINGS WITH TREASURY UNDERSECRETARY AND CENTRAL  
BANK GOVERNOR

REF: A. ANKARA 6886

[B](#). ANKARA 7096

[1](#)1. (Sbu) Treasury U/S Canakci told Econoffs that the IMF Sixth Review is unlikely to come to a Board vote before mid-December, since the Turkish parliament will need some time to pass the required legislation. Canakci also confirmed that the GOT will probably have to get parliamentary approval for the U.S. Financial Agreement, if the GOT decides to move forward on it. Separately, the Central Bank Governor defended the Central Bank's foreign exchange regime. He said the Central Bank is implicitly targeting inflation, but will not move to formal inflation targeting until its conditions are right. End Summary.

Meeting with Treasury U/S Canakci  
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[1](#)2. (Sbu) Econoffs met with Treasury Undersecretary Ibrahim Canakci November 14. Regarding the U.S. Financial Agreement (FA), Treasury legal experts have still not provided their formal opinion. Informally, however, Canakci said they are coming to the conclusion that the FA would have to go to Parliament for approval--a conclusion shared by MFA lawyers and the Director General of the Prime Ministry. Econcouns summarized the Ambassador's most recent conversation with MFA U/S Ziyal on the political conditionality (ref b). Canakci wryly noted that the political conditions were always public information on the U.S. Congress' web site and that no one ever raised this issue during the negotiations.

[1](#)3. (Sbu) Canakci explained the current status of the legislation strengthening the effectiveness of the BRSA. According to Canakci, the GOT and the IMF were in agreement on the two articles in the law which are required for the Sixth Review. These articles establish a special chamber in the courts to handle BRSA-related cases and put time limits on appeals of BRSA decisions. The recent controversy arises from other articles in the law, about which the IMF and the Bankers' Association have concerns. According to Canakci, the controversy stems from the transfer of asset collection powers from the BRSA to the Finance Ministry, and from the extension of penalties to a wide range of people. Canakci said that if the GOT cannot reach an understanding with the IMF, the two articles needed for the Sixth Review may be made into a separate law and passed without waiting for resolution of the other issues. The legislation is currently in the Justice Committee of Parliament.

[1](#)4. (Sbu) Canakci said the Public Financial Management and Control Law was under discussion in the Budget committee and would most likely be considered by the General Assembly after the Bayram holiday. The budget was also moving out of committee to the General Assembly, most likely the week of November 17. With all this IMF-required legislative work still ongoing, Canakci predicted that the IMF Board would not consider Turkey's Sixth Review before mid-December.

[1](#)5. (Sbu) On the macroeconomic targets, Canakci remains confident that Turkey will have no difficulty meeting the 6.5 percent primary surplus target for 2003, as well as the 5 percent GDP growth target and the 20 percent inflation target.

[1](#)6. (Sbu) In contrast with the good macro performance, Econcouns expressed concern about the lack of momentum on

structural reforms, noting the slowness of the privatization program and problems with the investment climate that will be an important theme at the upcoming Economic Partnership Commission meetings. Econcouns also commented on the need to maintain a strong, independent BRSA. In reply, Canakci only noted the GOT's desire to make progress in these areas and cited the GOT's intention to re-engage with the World Bank on structural reforms. On privatization, Canakci claimed the GOT gave a higher priority to developing the private sector than to maximizing the receipts from privatizations. On the failed Tekel tobacco tender, Canakci pointed out that the Finance Minister had made a mistake by raising expectations beforehand, since it is always better to have a positive surprise.

#### Meeting with Central Bank Governor Serdengeçti

17. (Sbu) In a meeting November 13, Central Bank Governor Serdengeçti worried about developments at the BRSA, saying that if the BRSA has a boss who follows the government, then "we have a problem." Serdengeçti also referred to problems at the BRSA unrelated to Akcakoca's departure: staff that came from Treasury were ultra-conservative and the sworn auditors were sometimes suspected of corruption.

18. (Sbu) Serdengeçti predicted that November price inflation might be above markets' expectations but that the 20 percent year-end inflation target would still be met. In early 2004, the inflation numbers will benefit from a base effect; however, the Governor thought that predictions of single-digit inflation by mid-year were too optimistic. Given the lag in monetary policy, the Central Bank is currently focused on 2004.

19. (Sbu) Serdengeçti characterized the Central Bank's current approach as "implicit inflation targeting," a concept he attributed to former IMF Deputy Managing Director Stanley Fischer. The Governor cautioned that the Bank does not want to move to formal inflation targeting until it is certain it will work. He described the necessary pre-conditions as: 1) a more certain fiscal situation with lower interest rates; and 2) labor union wage restraint including unions tying wage demands to expected--not historical--inflation rates.

110. (Sbu) In reply to concerns raised by former Economy Minister Kemal Dervis and others regarding the current account deficit, Serdengeçti, with characteristic bluntness, said that Dervis never understood the floating exchange rate regime. The Governor emphasized that the Bank was targeting inflation--not the exchange rate--and would not use its foreign exchange reserves to stabilize the currency because it needs the reserves to service the GOT's external debt and to manage the Central Bank's own costly foreign exchange-denominated liabilities. In reply to those who worry about the overvaluation of the Lira, he pointed out that the currency would have appreciated even more had the Central Bank not bought USD 10 billion over 6 months. The Bank had stopped buying foreign exchange in October because market participants were confused and had begun to speculate against the Lira. But the Bank was not targeting a particular level for the currency.

111. (Sbu) The Governor expressed some concerns about the way in which the GOT was handling the planned elimination of six zeroes in the currency. He emphasized that much preparation was needed, and that the draft legislation was already late. In his view, the currency change should take place at the beginning of a calendar year.

112. (Sbu) Serdengeçti agreed with Econcouns on the importance of reforms to attract more foreign direct investment. He recounted how, when questioned at public events about the desirability of foreign investment, the Governor responded: "Do you want 3 percent growth or 6 percent?" Serdengeçti said the Turkish savings rate was too low to achieve strong growth without foreign investment. He also suggested that the Turkish Treasury should be more vocal on FDI issues.